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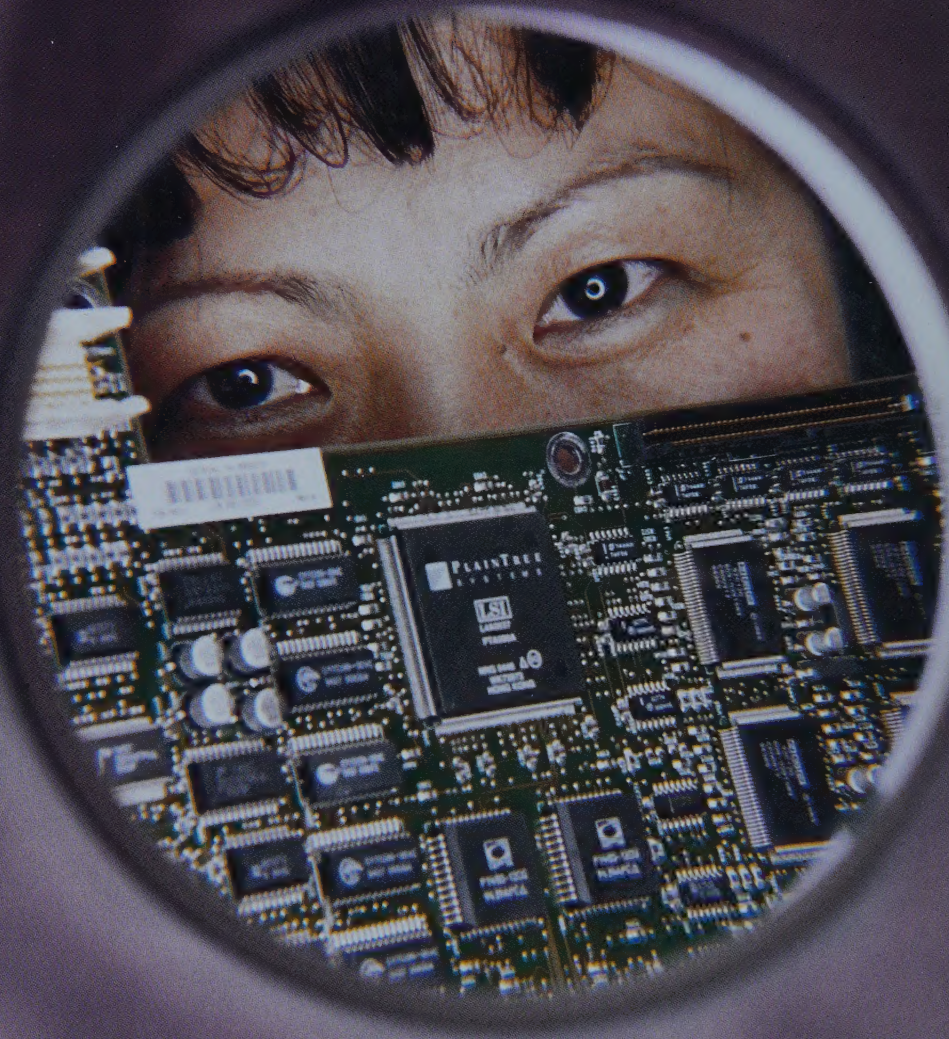
PLAINTREE
SYSTEMS

Annual Report
1996

Plaintree Systems is one of the world's leading developers and manufacturers of local area network switches.

These computer networking products allow organizations to improve the performance and simplify the management of their networks.

Plaintree is committed to being at the forefront of LAN switching technology.



REPORT TO SHAREHOLDERS

Fiscal 1996 was a difficult year for your Company. Revenue grew 16% from fiscal 1995, reaching \$31,417,312, but we incurred a net loss for the year of (\$10,556,453). Sales were lower than expected, due in part to the acquisition of our largest OEM customer by one of our competitors. Despite these challenges, we elected to invest in your Company's future by substantially increasing our research and development spending for the year. As a result, we now have a new family of leading-edge WaveSwitch products, with yet another generation to be added to our product line in fiscal 1997. Even though our R&D spending contributed to the loss in fiscal 1996, we expect this investment to pay off in improved results for 1997 and beyond.

Your Company's investment in product development leaves us well positioned to supply the large emerging market for enterprise-wide LAN switching solutions. Previously, the switch market was focused on localized applications such as boosting bandwidth for a workgroup or supporting high-speed server connections. Today, people are becoming concerned about providing enough bandwidth and management capability in the backbone to support enterprise-wide frame switching. As new high-bandwidth switching products begin to satisfy these enterprise needs, growth in the overall switching market will accelerate as smaller switches also experience increasing demand.

Our new WaveSwitch™ products are aimed at enterprise-wide switched networks. Built around Plaintree-designed multi-gigabit switch ASICs, they will integrate Gigabit Ethernet and high density 100Mbps fast Ethernet, supplying the large increase in bandwidth needed for enterprise networks. Coupled with Plaintree's industry-leading virtual LAN capability, we will have a more comprehensive frame switching solution than anything available today. We believe that users will welcome these developments, allowing your Company to capture its share of a rapidly growing market.



Bruce V. Walter
President and Chief Executive Officer



AROUND THE WORLD CUSTOMERS ARE SWITCHING TO PLAINTREE PRODUCTS.

Incorporated in 1985, Corel Corporation is recognized internationally as an award-winning developer and marketer of productivity applications, graphics and multimedia software. The company ships its products in over 17 languages through a network of more than 160 distributors in 70 countries worldwide.

"Corel's headquarters requires high performance LAN networks. In order to stay on the cutting edge of software design and marketing, employees must be able to communicate and share information as fast as technology will allow.

Plaintree's WaveSwitch products enable Corel to segment the Ethernet portions of their LANs into multiple collision domains, dramatically increasing network throughput and minimizing user's response times. The WaveSwitches also provide a cost effective way to bridge between FDDI backbones.

This combination of backbone integration and increased bandwidth to the desktop makes it ideal for Corel's needs of today, and provides support for and compatibility with the needs and emerging standards of tomorrow.

The implementation of Plaintree products at headquarters has been so successful that Corel has decided on the WaveSwitch line of products for its worldwide operations."

George Oneid
Director of MIS
Corel Corporation
Ottawa, Ontario, Canada

Makro Cash & Carry is one of Poland's largest Supermarket chains. Plaintree distributor Gandalf Polska has installed 12 port fiber optic WaveSwitch 100 FLs in each of Makro's major branches in Warsaw, Krakow, Katowice and Poznan. The Plaintree WaveSwitch was chosen to improve the efficiency of their network and to help their operations be price competitive.

"We are pleased with the Plaintree Ethernet switch technology installed in our retail stores by Gandalf Polska Ltd. In addition to offering high performance, they are also very reliable—a key requirement in our demanding application. The units have operated problem free."

Janusz Iladrys
Director IT
Makro Cash & Carry
Warsaw, Poland

"Our cooperation with Plaintree has been very good since the outset. In Poland we install and sell equipment for very demanding applications, and working with the manufacturer gives us the first hand competence we require. Plaintree has been very responsive to our requests. The technology is solid and we are very excited about the new products being announced"

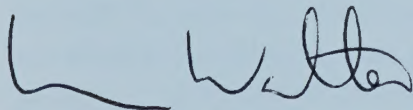
Stan Michalak
President
Gandalf Polska Ltd
Warsaw, Poland

We have taken steps in recent months to strengthen our marketing and sales organizations. Alan Greenfield has joined us as Senior Vice President - Marketing and Sales, and Paul Weiss has been hired as Vice President - Marketing. They bring considerable strength and experience to our team as we build our channel and end-user customer base. In addition, Girvan Patterson has been appointed Vice President - International Sales to drive sales to our network of distributors around the world.

We are very pleased that Colin Beaumont has agreed to join our Board of Directors. Colin led the research and development organizations at Northern Telecom and Bell-Northern Research for many years prior to his retirement from Bell-Northern last year. Colin's considerable experience and insight will help keep Plaintree at the forefront of the LAN switch market.

We are sorry to report that Des Cunningham has decided to retire and will not be standing for re-election as a director at the upcoming annual meeting. Des has been a key member of the Board for many years. On behalf of our shareholders, directors and employees we want to thank Des for the important contribution he has made to the growth of Plaintree.

The market for LAN switches continues to grow rapidly as networks continue to require greater and greater bandwidth. Your Company's significant investment in research and development and the dedication of its 161 employees will ensure that Plaintree captures its share of this dynamic market.

A handwritten signature in black ink, appearing to read "Bruce V. Walter". The signature is fluid and cursive, with the first name "Bruce" and last name "Walter" clearly distinguishable.

Bruce V. Walter
President and Chief Executive Officer



"Plaintree's WaveSwitch is planned to be the heart of the local area networks at 150 sites supporting the National Weather Service's Advanced Weather Interactive Processing System (AWIPS), which will provide up-to-the-minute weather products and forecast information to NWS meteorologists across the United States.

The system will facilitate forecast operations at Weather Forecast Offices and provide crucial information to River Forecast Centers responsible for flood watches and hydrometeorological forecasting.

Plaintree's WaveSwitch was selected for the system because of its cost-effectiveness, reliability, and its speed in transferring large files such as satellite imagery."

Dale A. Browne
Director of Engineering
PRC, Inc. - Prime contractor for AWIPS
McLean, Virginia

Arbella Mutual Insurance Company, devoted to offering insurance products to residents of Massachusetts, services over 450,000 policy owners through its network of 400 professional independent agents. Since 1988, the firm has dedicated all of its resources, including a top level investment portfolio and seasoned insurance experts, into building and maintaining comprehensive homeowner, automobile, boat owner, and personal umbrella insurance services.

"Adding users, building more segments on the network and offering higher speed server connections is what my end users expect of me.

In our search for a switch provider, the WaveSwitch met all the requirements we had for features and for high speed growth options for the future.

Plaintree products are an excellent choice for any LAN environment. The WaveSwitch units installed at Arbella have performed extremely well."

Ms. Lorna Keith
Technical Support Supervisor
Arbella Mutual Insurance Company
Boston, Massachusetts

REPORT ON PRODUCT DEVELOPMENT

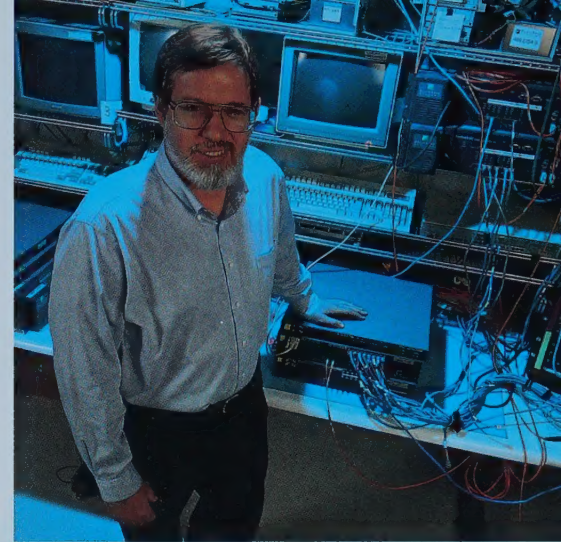
Our company's challenge is to lead the market in switching technology for local area networks.

Customers are quickest to adopt technologies that greatly enhance their capabilities with only incremental expenditure. Technologies that require total replacement of equipment or radically different management procedures will be adopted slowly, or not at all, unless they offer indispensable advantages.

The importance of incremental improvement led Plaintree to create switching products that enhance the performance of frame LANs, primarily Ethernet, 100VG, and FDDI. In particular, the predominance of Ethernet for desktop and server LAN connections, together with the introduction of 100 Mbps and 1000 Mbps (gigabit) versions of Ethernet, creates large opportunities for new LAN switching technology aimed primarily at Ethernet.

Plaintree shipped its third generation of switching products at the end of fiscal 1996. The WaveSwitch 1216, a modular departmental switch, and the WaveSwitch 1018, a non-modular workgroup switch, were the first products to be based on the PTA600 switching ASIC which has been in development since early 1994. The WaveSwitch 4800, a pure 100 Mbps modular switch, will ship in August 1996.

These third-generation switches enhance the performance and simplify the management of customer LANs. The WaveSwitch 1216 and 1018 replace the functions of the earlier WaveSwitch 100 family with greater 10/100 switching capacity, lower cost, and enhanced management capabilities, including bundled RMON and virtual LAN features in all switches. The WaveSwitch 4800 addresses customer needs for a high capacity 100 Mbps top-of-network switch to interconnect departmental and workgroup switches via FDDI, Fast Ethernet, or a combination of both.



*David M. Delaney
Chairman and Director of Product Development*



The Bureau of National Affairs, Inc. (BNA), is a leading publisher of print and electronic news and information services, recognized worldwide for editorial excellence and comprehensive coverage of the legal, business, tax, labor, environment, health and safety fields.

Headquartered in the nation's capital since its inception in 1929, and incorporated as an independent, 100% employee owned publishing company in 1947, BNA produces more than 200 news and information services, including a number of highly respected daily publications.

"The Plaintree WaveSwitch is utilized in the network that supports the Sun workstations used by our editors for print and electronic publishing, which is our core business. The editors work on tight deadlines, so they must have speed and reliability. That is what the Plaintree WaveSwitch delivers."

Alex Rosenbaum
Manager, Network Engineering
The Bureau of National Affairs, Inc. (BNA),
Washington, D.C.

Over the last 12 years, GTECH Corporation, an \$800 million company, has been a custom designer of state lottery gaming machines. The engineers at GTECH create not only the firmware and software for gaming and Powerball lotto systems, but also for automated drivers' license renewals and for the provision of debit cards to welfare recipients for fraud prevention.

GTECH Corporation's engineering network consists of 130 high performance nodes. Prior to installing Plaintree's WaveSwitch there were no routers or bridges; everything ran on one backbone. For design engineers using powerful CAD workstations to develop 3-D models of prototypes, this created a problem.

"The network traffic in our engineering department was so heavy, I had to do something right away. I knew that Plaintree's WaveSwitch product was one of the fastest on the market and that it was plug-and-play. I tried WaveSwitch and I immediately liked it. Before installing the WaveSwitch product we were experiencing utilization bursts of 95 to 98 percent. Since installing WaveSwitch our bursts are down to 50 percent. That's a big improvement!"

Tom Cader
System/Network Administrator
GTech Corporation
West Greenwich, Rhode Island

Our next generation ASICs, now in final development, will support switching products that enable LANs to carry large amounts of multimedia traffic. The deployment of multimedia applications in the LAN will accelerate in late 1997 as new standards for multimedia transport over the Internet come on line. As a result, many customers will be planning to deploy much greater bandwidth in the LAN. Until recently, such plans were necessarily based on ATM as the only technology offering transport bandwidths scaling up to a gigabit per second and providing for enhanced quality of service for multimedia traffic. The introduction of Gigabit Ethernet and multi-gigabit switching for Ethernet will make Ethernet more attractive than ATM for many customers. Such customers will avoid the high costs of converting back and forth between frames on the desktop and cells in the ATM backbone. They will also avoid the costs of managing a heterogeneous LAN using multiple technologies that require very different kinds of expertise.

To pursue these opportunities, Plaintree is focusing fourth-generation product development on multi-gigabit high-fanout 100 Mbps and 1000 Mbps Ethernet switching, with the quality of service and virtual LAN capabilities required by the new applications.

One of our main development challenges is to accelerate the rate at which new product generations are added to our WaveSwitch family. The fourth WaveSwitch generation will benefit greatly from the re-use of components of the intellectual property developed for the third generation. This will enable us to dramatically reduce the time between product generations. Fourth generation switches are expected to ship in quantity in the final quarter of fiscal 1997, less than one year after the introduction of our third generation. With these new switches, we are confident that our WaveSwitch family will continue to offer a leading frame switching solution for enterprise networks.

A handwritten signature in dark ink, reading "D Delaney". The "D" is large and stylized, with a loop. The name "Delaney" is written in a cursive script.

David Delaney
Chairman and Director of Product Development

THIRD GENERATION PLAINTREE WAVESWITCH PRODUCTS.



WAVESWITCH 1018, 1216, 4800.

AUDITORS' REPORT

To the Shareholders of Plaintiff Systems Inc.:

We have audited the consolidated balance sheets of Plaintiff Systems Inc. as at March 31, 1996 and 1995 and the consolidated statements of operations and deficit and changes in cash flows for the years ended March 31, 1996, 1995, and 1994. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at March 31, 1996 and 1995 and the results of its operations and the changes in its cash flows for the years ended March 31, 1996, 1995 and 1994 in accordance with accounting principles generally accepted in Canada, which also conform in all material respects with accounting principles generally accepted in the United States.



Chartered Accountants
Ottawa, Canada
April 19, 1996

1996

FINANCIAL STATEMENTS

PLAINTREE SYSTEMS INC.
CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT

YEAR ENDED MARCH 31, 1996

	1994	1995	1996
Sales	\$ 3,273,079	\$ 27,192,426	\$ 31,417,312
Cost of sales	<u>1,531,321</u>	<u>13,720,540</u>	<u>19,371,860</u>
Gross margin	<u>1,741,758</u>	<u>13,471,886</u>	<u>12,045,452</u>
Operating expenses			
Selling and technical support	4,057,060	8,955,800	10,185,362
Finance and administration	1,368,198	1,334,494	1,925,369
Research and development (Note 8)	2,576,134	3,949,991	6,737,350
Provision for excess inventory	<u>-</u>	<u>-</u>	<u>3,850,000</u>
	<u>8,001,392</u>	<u>14,240,285</u>	<u>22,698,081</u>
Loss from operations	(6,259,634)	(768,399)	(10,652,629)
Interest income (Note 9)	162,151	110,709	342,434
Other (Note 10)	<u>103,127</u>	<u>32,933</u>	<u>(246,258)</u>
Loss before income taxes	(5,994,356)	(624,757)	(10,556,453)
Income taxes (Note 11)	<u>-</u>	<u>-</u>	<u>-</u>
NET LOSS	(5,994,356)	(624,757)	(10,556,453)
DEFICIT, BEGINNING OF YEAR	<u>(4,026,754)</u>	<u>(10,021,110)</u>	<u>(10,645,867)</u>
DEFICIT, END OF YEAR	<u>\$ (10,021,110)</u>	<u>\$ (10,645,867)</u>	<u>\$ (21,202,320)</u>
Earnings per share (Note 12)	<u>\$ (0.67)</u>	<u>\$ (0.06)</u>	<u>\$ (0.78)</u>
Weighted average common shares outstanding	<u>8,976,398</u>	<u>11,033,921</u>	<u>13,507,851</u>

PLAINTREE SYSTEMS INC.
CONSOLIDATED BALANCE SHEETS

AS AT MARCH 31, 1996

	1995	1996
CURRENT ASSETS		
Cash and cash equivalents	\$ 3,270,963	\$ 6,356,143
Trade accounts receivable, net of provision for doubtful accounts of \$100,000 (1995 - \$20,000)	13,778,411	6,535,765
Other accounts receivable (Note 3)	624,834	1,119,135
Inventories (Note 4)	7,682,663	12,363,176
Prepaid expenses and advance contract payments	494,747	2,718,545
	<u>25,851,618</u>	<u>29,092,764</u>
CAPITAL ASSETS (Note 5)	2,277,402	3,753,021
OTHER ASSETS	<u>-</u>	<u>1,355,000</u>
	<u>\$ 28,129,020</u>	<u>\$ 34,200,785</u>
CURRENT LIABILITIES		
Accounts payable	\$ 6,133,332	\$ 3,847,612
Accrued liabilities	1,133,188	1,484,938
Salaries and benefits payable	161,929	420,818
Accrued commissions payable	1,219,302	1,037,491
Current portion of bank loan and obligations under capital leases (Note 6)	149,366	184,946
	<u>8,797,117</u>	<u>6,975,805</u>
BANK LOAN AND OBLIGATIONS UNDER CAPITAL LEASES (Note 6)	<u>217,000</u>	<u>573,000</u>
	<u>9,014,117</u>	<u>7,548,805</u>
SHAREHOLDERS' EQUITY		
Share capital (Note 7)	30,045,363	48,050,468
Deficit	(10,645,867)	(21,202,320)
Deferred foreign exchange loss	(284,593)	(196,168)
	<u>19,114,903</u>	<u>26,651,980</u>
	<u>\$ 28,129,020</u>	<u>\$ 34,200,785</u>



David M. Delaney
Director



Bruce V. Walter
Director

PLAINTREE SYSTEMS INC.
CONSOLIDATED STATEMENTS OF CHANGES IN CASH FLOWS

YEAR ENDED MARCH 31, 1996

	1994	1995	1996
OPERATING			
Net loss	\$ (5,994,356)	\$ (624,757)	\$ (10,556,453)
Item not affecting cash			
Amortization of capital assets	256,882	857,488	1,542,202
Changes in non-cash working capital items	(2,342,456)	(11,890,661)	(2,034,618)
	(8,079,930)	(11,657,930)	(11,048,869)
INVESTING			
Purchases of capital assets	(1,515,097)	(1,694,555)	(3,017,821)
Purchase of software licenses	-	-	(1,355,000)
	(1,515,097)	(1,694,555)	(4,372,821)
FINANCING			
Increase in capital leases	-	180,245	174,178
Payments on capital leases	(5,913)	(41,295)	(136,644)
Increase in bank loan payable	-	250,000	412,500
Payment of bank loan payable	-	(50,400)	(58,454)
Share capital issued	9,884,410	45,111	18,005,105
Stock warrants issued for cash	7,007,500	9,113,744	-
Share capital issued on conversion of warrants	-	16,121,244	-
Warrants converted to share capital	-	(16,121,244)	-
	16,885,997	9,497,405	18,396,685
Effect of foreign currency translation on cash flow	(119,628)	(95,965)	110,185
Increase (decrease) in cash and cash equivalents	7,171,342	(3,951,045)	3,085,180
Cash and cash equivalents, beginning of period	50,666	7,222,008	3,270,963
Cash and cash equivalents, end of period	\$ 7,222,008	\$ 3,270,963	\$ 6,356,143

1. DESCRIPTION OF BUSINESS

The Company designs, develops, manufactures, markets and supports computer networking products that allow its customers to improve the performance and increase the manageability of their existing local area networks, while providing a migration path to emerging networking technologies.

2. ACCOUNTING POLICIES

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in Canada, and also conform in all material respects with accounting principles generally accepted in the United States.

Basis of presentation

The consolidated financial statements include the accounts of the Company and its wholly owned U.S. subsidiary, Plaintree Systems Corp., which commenced operations in September 1993. All significant intercompany accounts and transactions have been eliminated.

Inventories

Finished goods are valued at the lower of cost (first-in, first-out) and net realizable value. Work in process and raw materials are valued at the lower of cost and replacement cost.

Capital assets

Capital assets are stated at cost. Amortization is provided using the following methods and rates:

Software	2 years straight-line
Computer and office equipment	3 years straight-line
Furniture and fixtures	20% declining-basis
Leasehold improvements	Straight-line over the lease term
Building	20 years straight-line

Other assets

Other assets consist of software licenses and are recorded at cost. Amortization is provided on a per unit basis over the expected life of the underlying products. To date, no amortization has been recorded.

Research and development costs

Research costs are expensed as incurred. Development costs are deferred once technical feasibility has been established and all criteria for deferral under generally accepted accounting principles are met. Such costs are amortized, commencing when the product is released, over the lesser of the expected life of the related product or three years. To date, no development costs have met the criteria for deferral.

2. ACCOUNTING POLICIES (Continued)

Investment tax credits and government assistance

Investment tax credits and government assistance are recorded using the cost reduction method.

Revenue recognition and warranties

Revenue from product sales is recorded on shipment or customer acceptance. In addition, a provision for potential warranty claims is provided for at the time of sale, based on warranty terms and prior claims experience. Service revenue is recognized when the service is performed, or, in the case of maintenance contracts, is recognized on a straight-line basis over the term of the contract.

Foreign currency translation

The current rate method is used to translate the financial statements of the Company's foreign subsidiary into Canadian dollars, as the subsidiary is considered to be self-sustaining. The resulting translation adjustment is deferred as a separate component of shareholders' equity until there is a realized reduction in the net investment in the subsidiary.

Other monetary assets and liabilities, which are denominated in currencies foreign to the local currency of any one operation, are translated to the local currency at fiscal year-end exchange rates, and transactions included in earnings are translated at rates prevailing during the fiscal year. Exchange gains and losses resulting from the translation of these amounts are included in the Consolidated Statements of Operations and Deficit.

Concentration of credit risk

Financial instruments which potentially subject the Company to a concentration of credit risk consist principally of cash investments and trade receivables. The Company primarily invests its excess cash in high-quality financial instruments. The Company has credit evaluation, approval and monitoring processes intended to mitigate potential credit risks. Anticipated bad debt loss has been provided for in the provision for doubtful accounts. The carrying amounts for cash and cash equivalents, accounts receivable, accounts payable and other current liabilities approximate fair market value due to the short maturity of these instruments.

Cash equivalents

Cash equivalents are highly liquid debt investments acquired with a maturity of three months or less.

2. ACCOUNTING POLICIES (Continued)

Stock Based Compensation

The Company accounts for its stock option plan in accordance with the provisions of the Accounting Principles Board's Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees." In 1995, the Financial Accounting Standards Board released the Statement of Financial Accounting Standard No. 123 ("SFAS 123"), "Accounting for Stock Based Compensation." SFAS 123 provides an alternative to APB 25 and is effective for fiscal years beginning after December 15, 1995. The Company expects to continue to account for its employee stock plans in accordance with the provisions of APB 25. Accordingly, SFAS 123 is not expected to have a material impact on the Company's financial position or results of operations.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts in the financial statements and accompanying notes. Actual results could differ from those estimates.

3. OTHER ACCOUNTS RECEIVABLE

	1995	1996
Non-refundable investment tax credits	\$ -	\$ 847,262
Goods and services tax refund	567,350	173,399
Other	<u>57,484</u>	<u>98,474</u>
	<u>\$ 624,834</u>	<u>\$ 1,119,135</u>

4. INVENTORIES

	1995	1996
Raw materials	\$2,355,344	\$ 6,067,882
Work in process	3,388,530	2,056,127
Finished goods	<u>1,938,789</u>	<u>4,239,167</u>
	<u>\$7,682,663</u>	<u>\$12,363,176</u>

PLAINTREE SYSTEMS INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

5. CAPITAL ASSETS

	March 31, 1995	March 31, 1996		
	Net Book		Accumulated	Net Book
	Value	Cost	Depreciation	Value
Software	\$ 255,342	\$1,089,646	\$ 715,511	\$ 374,135
Computer and office equipment	1,402,889	3,914,683	1,733,918	2,180,765
Furniture and fixtures	234,766	515,295	195,045	320,250
Leasehold improvements	384,405	605,236	302,425	302,811
Land and building	-	577,467	2,407	575,060
	<u>\$2,277,402</u>	<u>\$6,702,327</u>	<u>\$2,949,306</u>	<u>\$3,753,021</u>

Computer and office equipment and furniture and fixtures include items under capital lease with a total cost of \$272,193 (1995 - \$224,126) and a net book value of \$173,964 (1995 - \$162,221). Accumulated government assistance of \$865,320 (1995 - \$693,058), including investment tax credits, has been applied in reduction of the cost of capital assets.

6. BANK LOAN AND OBLIGATIONS UNDER CAPITAL LEASES

	1995	1996
Bank loan, bearing interest at 8%, principal and interest repayable in monthly installments of \$3,417, maturing February 1999	\$ -	\$404,447
Bank loan, bearing interest at prime plus 1.5%, principal repayable in monthly installments of \$4,200 to March 1999	199,600	149,200
Various capital lease obligations, bearing interest at rates ranging from 7.6% to 20.3%, payable in blended monthly installments ranging from \$211 to \$4,389 and with expiry dates ranging between September 1996 and May 1999	<u>166,766</u>	<u>204,299</u>
	366,366	757,946
Less current portion	<u>(149,366)</u>	<u>(184,946)</u>
	<u>\$217,000</u>	<u>\$573,000</u>

PLAINTREE SYSTEMS INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

6. BANK LOAN AND OBLIGATIONS UNDER CAPITAL LEASES (Continued)

The bank loan and capital lease obligations are secured by specific capital assets of the Company.

Future minimum payments are as follows:

	<u>Capital Lease Obligations</u>	<u>Bank Loans</u>	<u>Total</u>
1997	\$141,000	\$102,000	\$243,000
1998	40,000	98,000	138,000
1999	40,000	92,000	132,000
2000	7,000	41,000	48,000
2001	-	41,000	41,000
Thereafter	<u>-</u>	<u>362,000</u>	<u>362,000</u>
	228,000	736,000	964,000
Less interest	<u>(23,701)</u>	<u>(182,353)</u>	<u>(206,054)</u>
	<u>\$204,299</u>	<u>\$553,647</u>	<u>\$757,946</u>

Interest expense on bank loans and obligations under capital leases was \$34,000, \$51,000 and \$4,200 for the years ended March 31, 1996, 1995 and, 1994, respectively.

PLAINTREE SYSTEMS INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

7. SHARE CAPITAL

Authorized

Unlimited number of non-voting preferred shares, issuable in series

Unlimited number of common shares

The following is a summary of the changes in issued share capital:

	<u>Common Shares</u>		<u>Series 10 Preferred Shares</u>		<u>Series 11 Preferred Shares</u>		<u>Series 12 Preferred Shares</u>		<u>Total</u>
	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	<u>Number</u>	<u>Amount</u>	
Outstanding March 31, 1993	2,972,321	\$ 525,254	6,640,657	\$ 2,473,166	20,000,000	\$ 978,816	49,608	\$ 17,362	\$ 3,994,598
Conversion of shares upon amalgamation	4,692,577	3,469,344	(6,640,657)	(2,473,166)	(20,000,000)	(978,816)	(49,608)	(17,362)	-
Exercise of stock options net of \$103,609 issue costs	319,906	1,747,284	-	-	-	-	-	-	1,747,284
Public issue net of \$962,874 issue costs	1,300,000	8,137,126	-	-	-	-	-	-	8,137,126
Outstanding March 31, 1994	9,284,804	13,879,008	-	-	-	-	-	-	13,879,008
Conversion of stock warrants net of \$1,378,756 issue costs	2,833,333	16,121,244	-	-	-	-	-	-	16,121,244
Exercise of stock options	180,447	45,111	-	-	-	-	-	-	45,111
Outstanding March 31, 1995	12,298,584	30,045,363	-	-	-	-	-	-	30,045,363
Public issue net of \$401,600 issue costs	1,500,000	17,949,550	-	-	-	-	-	-	17,949,550
Exercise of stock options	15,741	55,555	-	-	-	-	-	-	55,555
Outstanding March 31, 1996	13,814,325	\$ 48,050,468	-	\$ -	-	\$ -	-	\$ -	\$ 48,050,468

7. SHARE CAPITAL (Continued)

The Company has a stock option plan for key employees and directors. Eligibility is determined by the Company's board of directors. The aggregate number of shares available for issuance under the plan is not permitted to exceed 1,500,000 authorized but unissued common shares, and the aggregate number available for issuance to any one person may not exceed 5% of the issued and outstanding common shares. Options may not expire later than 10 years from the date of grant and the exercise price may not be less than the latest closing price of the common shares on the last trading day preceding the date of grant.

Activity in the stock option plan is summarized as follows:

	<u>Number of options</u>	<u>Option Price</u>
Options outstanding July 31, 1993	240,313	\$ 0.25
Granted during fiscal 1994	705,200	\$ 7.00
Cancelled	(969)	\$ 0.25
Exercised	<u>(57,306)</u>	\$ 0.25
Options outstanding March 31, 1994	887,238	\$ 0.25 - \$ 7.00
Granted during fiscal 1995	554,300	\$ 3.90 - \$13.88
Cancelled	(372,300)	\$ 3.90 - \$ 7.38
Exercised	<u>(180,447)</u>	\$ 0.25
Options outstanding March 31, 1995	888,791	\$ 0.25 - \$13.88
Granted during fiscal 1996	620,250	\$ 8.50 - \$10.25
Cancelled	(155,800)	\$ 3.90 - \$19.50
Exercised	<u>(15,741)</u>	\$ 0.25 - \$ 3.90
Options outstanding March 31, 1996	<u>1,337,500</u>	\$ 0.25 - \$19.50

In September 1995, the Company's board of directors approved a reduction in the exercise price for 37,000 employee stock options granted in January 1995 at \$10.83 per share and 193,750 employee stock options granted in April 1995 at \$19.20 per share to \$10.25 per share, the closing price of the Company's common shares on the Toronto Stock Exchange on the date of change. No options granted to corporate officers were included in the option price reduction.

PLAINTREE SYSTEMS INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

8. RESEARCH AND DEVELOPMENT

	1994	1995	1996
Research and development costs	\$2,720,338	\$3,949,991	\$7,412,350
Less: Investment tax credits	<u>(144,204)</u>	<u>-</u>	<u>(675,000)</u>
	<u>\$2,576,134</u>	<u>\$3,949,991</u>	<u>\$6,737,350</u>

9. INTEREST INCOME

Interest income in fiscal 1996 is presented net of interest expense in the amount of \$54,643 (1995 - \$57,020; 1994 - \$4,200).

10. OTHER

Other includes a foreign exchange loss of \$243,788 (1995 - gain of \$66,848; 1994 - gain of \$108,169) and other expenses of \$2,470 (1995 - \$33,915; 1994 - \$5,042).

11. INCOME TAXES

(a) Investment tax credits

At March 31, 1996, the Company has approximately \$2,726,500 (1995 - \$1,401,500) of investment tax credits, relating primarily to research and development, available to reduce future years Canadian federal income taxes. During the current year, the Company recorded \$847,262 relating to investment tax credits. These potential benefits expire as follows:

1998	\$ 8,000
1999	34,000
2000	13,000
2001	8,000
2002	500
2003	8,000
2004	505,000
2005	825,000
2006	<u>1,325,000</u>
	<u>\$2,726,500</u>

PLAINTREE SYSTEMS INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

11. INCOME TAXES (Continued)

(b) Losses available to carry forward

The Company has losses available to reduce future years' Canadian federal and provincial taxable income and foreign taxable income. These losses total approximately \$3,860,000, \$17,059,000 and \$4,900,000, respectively. These potential benefits expire as follows:

	<u>Federal</u>	<u>Provincial</u>	<u>Foreign</u>
1997	\$ -	\$ 310,000	\$ -
1998	-	1,564,000	-
1999	-	1,215,000	-
2000	-	725,000	-
2001	-	6,495,000	-
2002	1,860,000	2,600,000	-
2003	2,000,000	4,150,000	-
2009	-	-	1,600,000
2010	-	-	700,000
2011	<u>-</u>	<u>-</u>	<u>2,600,000</u>
	<u>\$3,860,000</u>	<u>\$17,059,000</u>	<u>\$4,900,000</u>

In addition, the Company has claimed less research and development expenses for income tax purposes than has been reflected in the financial statements. These unclaimed expenses total approximately \$12,400,000 (1995 - \$7,600,000) for Canadian federal income tax purposes and \$4,700,000 (1995 - nil) for Canadian provincial income tax purposes. These are available without expiry to reduce future years' taxable income.

The provision for income taxes reported differs from the amount computed by applying the Canadian statutory rate to the loss before income taxes for the following reasons:

	1994	1995	1996
Statutory income tax rate (Canada)	44.3%	44.3%	44.6%
Expected provision for income tax	\$(2,655,500)	\$(276,767)	\$(4,708,178)
Loss carryforwards not utilized	2,647,800	225,767	4,512,347
Foreign tax differential	-	40,800	185,031
Other	<u>7,700</u>	<u>10,200</u>	<u>10,800</u>
Reported income tax provision	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

PLAINTREE SYSTEMS INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

11. INCOME TAXES (Continued)

The source of accumulated timing differences and related deferred income taxes as at March 31 are as follows:

	1994	1995	1996
Tax depreciation in excess of accounting	\$ (74,621)	\$ (147,174)	\$ (112,310)
Research and development expenses not deducted for tax purposes to date	1,570,421	2,372,107	4,074,706
Losses available to offset future income taxes	3,189,229	2,779,740	4,819,198
Other	<u>63,647</u>	<u>61,041</u>	<u>651,122</u>
Deferred income tax debits before valuation allowance	4,748,676	5,065,714	9,432,716
Less valuation allowance	<u>(4,748,676)</u>	<u>(5,065,714)</u>	<u>(9,432,716)</u>
Deferred income taxes	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

12. EARNINGS PER SHARE

Earnings per share have been calculated on the basis of net loss divided by the weighted average number of common shares outstanding during the period. For all periods presented, fully diluted earnings per share are not disclosed as they are anti-dilutive.

For all periods presented, primary and fully diluted earnings per share under United States generally accepted accounting principles are not materially different from amounts presented under Canadian generally accepted accounting principles.

13. BANK CREDIT FACILITIES

The Company has a bank credit facility consisting of a \$3,100,000 line of credit secured by substantially all of the assets of the Company. As at March 31, 1996, the facility was not in use.

14. COMMITMENTS

The Company is committed under lease contracts for the rental of its premises and certain equipment in the aggregate amount of approximately \$451,000.

Annual lease payments over the life of the leases are as follows:

1997	\$292,000
1998	153,000
1999	4,000
2000	<u>2,000</u>
	<u>\$451,000</u>

14. COMMITMENTS (Continued)

The Company was awarded a Microelectronics and System Development Program (MSDP) grant during 1991 for approximately \$1,800,000 to assist in the development and commercialization of certain of its products. This grant is repayable to the government in the form of a royalty of two percent of total sales attributable to those products. This royalty does not apply to the Company's WaveSwitch line of products.

15. SEGMENTED INFORMATION

	Year ended March 31, 1996			
	<u>Canada</u>	<u>U.S.</u>	<u>Elimination</u>	<u>Total</u>
Segment revenue				
External	\$ 11,427,594	\$19,989,718	\$ -	\$ 31,417,312
Inter segment	<u>15,811,459</u>	<u>-</u>	<u>(15,811,459)</u>	<u>-</u>
	<u>\$ 27,239,053</u>	<u>\$19,989,718</u>	<u>\$(15,811,459)</u>	<u>\$ 31,417,312</u>
Operating income (loss)	<u>\$(12,845,331)</u>	<u>\$ 2,192,702</u>		<u>\$(10,652,629)</u>
Interest income				342,434
Other				<u>(246,258)</u>
Net loss				<u>\$(10,556,453)</u>
Identifiable assets	<u>\$ 29,748,637</u>	<u>\$ 4,452,148</u>	<u>\$ -</u>	<u>\$ 34,200,785</u>

	Year ended March 31, 1995			
	<u>Canada</u>	<u>U.S.</u>	<u>Elimination</u>	<u>Total</u>
Segment revenue				
External	\$ 8,075,337	\$19,117,089	\$ -	\$27,192,426
Inter segment	<u>13,125,336</u>	<u>-</u>	<u>(13,125,336)</u>	<u>-</u>
	<u>\$21,200,673</u>	<u>\$19,117,089</u>	<u>\$(13,125,336)</u>	<u>\$27,192,426</u>
Operating income (loss)	<u>\$ (124,924)</u>	<u>\$ (643,475)</u>		<u>\$ (768,399)</u>
Interest income				110,709
Other				<u>32,933</u>
Net loss				<u>\$(624,757)</u>
Identifiable assets	<u>\$15,388,881</u>	<u>\$12,740,139</u>	<u>\$ -</u>	<u>\$28,129,020</u>

PLAINTREE SYSTEMS INC.
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

15. SEGMENTED INFORMATION (Continued)

As at March 31, 1994, the revenues and identifiable assets of the Company's foreign subsidiary were not significant and accordingly, no segmented geographic information is presented.

Segmented industry information is not presented as the Company is considered to operate in one industry segment, the computer networking industry.

Export sales outside Canada and the U.S. were \$6,497,000 (1995 - \$5,061,409; 1994 - \$917,731).

Sales in excess of 10 percent of the Company's reported sales were made to only one customer during the period who accounted for 14 percent. Comparatively, in 1995, five individual customers accounted for 20, 13, 13, 12, and 11 percent of reported sales respectively and in 1994, one customer accounted for 68 percent of reported sales.

16. COMPARATIVE FIGURES

Certain of the prior year's comparative figures have been reclassified to conform with the presentation adopted in the current year.

PLAINTREE SYSTEMS INC.

MANAGEMENT DISCUSSION AND ANALYSIS

OVERVIEW

The Company was incorporated and commenced operations in April 1988. From its inception through December 1992, the Company's business operations consisted primarily of product development activities. In December 1992, the Company began commercial shipments of WaveBus (a 100Mbps fiber optic Fast Ethernet product) and its related WaveBridge product line (which connected 10Mbps Ethernet LANs to WaveBus). At the same time, the Company introduced its MSL (Mirrored Server Link) product line. The Company's United States operations began in September, 1993.

The Company announced its WaveSwitch line of Ethernet switching products, which replaced the WaveBridge product line, during the quarter ended September 30, 1993. Initial customer shipments of WaveSwitch products began in March 1994 and volume shipments began in the first fiscal quarter of 1995. The Company's next generation of WaveSwitch products began commercial shipment late in the fourth fiscal quarter of 1996. The new 1000 and 4000 series of WaveSwitch products now enable the Company to offer network switching solutions from the desktop through to the data center.

The Company has sales distribution agreements for the WaveSwitch products with several OEMs. Sales to OEMs accounted for 54% of sales for fiscal 1996. The Company also distributes its products through VARs, distributors and systems integrators, and in Canada through an exclusive sales agent. The gross margins recognized by the Company vary significantly by distribution channel. However, the Company believes that the operating margin realized by each channel will be relatively comparable because differences in gross margins generally will be offset by differences in sales, marketing and administrative expenses. In addition, gross margin has varied, and is expected to continue to vary, from period to period because of several factors other than distribution channels, including changes in product mix, discount levels, new product introductions and production levels.

Approximately 84% of the Company's sales in fiscal 1996 were invoiced in United States dollars. Also, a majority of the Company's expenses were incurred in United States dollars during fiscal 1996. Increases in the value of the Canadian dollar relative to the United States dollar could adversely affect the Company's results of operations. The accounts of the Company's United States subsidiary are translated into Canadian dollars using the current rate method. The resulting translation adjustment arising from changes in foreign exchange rates is deferred as a separate component of shareholders' equity in the consolidated balance sheet. Gains and losses on foreign currency transactions entered into by the parent company are included in other income in the consolidated statement of operations.

To date, the Company has not entered into formal foreign currency hedging transactions as the exposure to changes in foreign exchange rates has not been material. Management monitors this situation and, if necessary, may decide to use various foreign currency hedging alternatives in the future.

Since the Company markets its products through OEMs, VARs, distributors and agents, the Company's success depends to a significant extent upon the ability of these parties to sell the Company's products in their respective markets. Numerous other factors affect fluctuations in the Company's quarterly and annual operating results including the timing of orders from and shipments to major customers, the timing of new product introductions by the Company and its competitors, market acceptance of new and enhanced versions of the Company's products, increased competition, changes in manufacturing costs, changes in the mix of product sales, changes in the mix of distribution channels, inability to obtain sufficient supplies of sole or limited source components and changes in world economic conditions.

PLAINTREE SYSTEMS INC.
MANAGEMENT DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS

The following table summarizes the Company's statement of operations as a percentage of sales for the last three fiscal years ended March 31.

Percentage of Total Sales

	<u>Fiscal Year Ended March 31,</u>		
	<u>1994</u>	<u>1995</u>	<u>1996</u>
Sales	100%	100%	100%
Cost of sales	<u>47</u>	<u>51</u>	<u>62</u>
Gross margin	<u>53</u>	<u>49</u>	<u>38</u>
Operating expenses;			
Selling and technical support	124	33	32
Finance and administration	42	5	6
Research and development	79	14	22
Provision for excess inventory	<u>-</u>	<u>-</u>	<u>12</u>
	<u>245</u>	<u>52</u>	<u>72</u>
Loss from operations	(191)	(3)	(34)
Other income	<u>8</u>	<u>1</u>	<u>-</u>
Earnings (loss) before income taxes	(183)	(2)	(34)
Income taxes	<u>-</u>	<u>-</u>	<u>-</u>
Net loss	<u>(183)%</u>	<u>(2)%</u>	<u>(34)%</u>

Sales

Sales increased by \$4.2 million from \$27.2 million in 1995 to \$31.4 million in 1996. This growth occurred despite a decreasing demand for first generation WaveSwitch 100 products and the loss of the Company's largest OEM as a result of an acquisition by a competing company. Third generation products were introduced and commenced commercial shipments late in the year in quantities insufficient to materially impact sales.

Sales of WaveSwitch 100 products represented approximately 80% of total sales compared to 87% in 1995. The Company's Mirrored Server Link (MSL) product line represented 16% of total sales (4% in 1995) with WaveBus products and the new third generation WaveSwitch product line making up the balance.

Gross Margins

In fiscal 1996, the Company saw its gross margins decline to 38% from 49% in the previous year. This decline resulted from a decrease in the selling prices of the WaveSwitch product line as a result of extreme price competition on the WaveSwitch 100 product line. No material increases in the cost of production were experienced. The Company reserved for remaining WaveSwitch 100 inventory at the end of the fiscal year.

PLAINTREE SYSTEMS INC.
MANAGEMENT DISCUSSION AND ANALYSIS

RESULTS OF OPERATIONS

Selling, Marketing and Technical Support

Selling, marketing and technical support costs increased to \$10.2 million in fiscal 1996 from \$9.0 million in fiscal 1995. These costs represent worldwide marketing and technical support costs of the Company's OEMs, VARs, distributor, agent and direct distribution channels. The \$1.2 million increase in the fiscal year was as a result of three new sales offices being opened in the United States, expansion of the European sales office and inauguration of a United States-based telesales initiative.

Finance and Administration

There was no material change in finance and administration costs as a percentage of sales in fiscal 1996 compared to fiscal 1995. In absolute dollars, expenses increased by \$.6 million year over year as the infrastructure to support future anticipated growth was solidified. No significant increase occurred in any one area.

Research and Development

Research and development costs increased by \$2.8 million from \$3.9 million in fiscal 1995 to \$6.7 million in the current fiscal period. This increase was the result of the Company's efforts to broaden its product line in order to be able to offer end-to-end network switches. Increases during the current period consisted of a significant increase in research and development personnel of \$1.1 million and an increase in direct new product development and testing costs of \$1.3 million.

Due to the competitiveness of the switching market and constant changes in related technologies, the Company anticipates that research and development costs will continue to be significant.

Provision for Excess Inventory

The Company recorded a reserve against excess WaveSwitch 100 inventory during the 1996 fiscal year. The excess inventory arose as a result of a decision by the Company to accumulate WaveSwitch 100 components in anticipation of continued sales volumes consistent with those of the fourth quarter of fiscal 1995 and to counterbalance the long lead-times that the Company was experiencing on certain key components. A subsequent loss of the Company's largest OEM by way of an acquisition by a competing company and lower than anticipated sales resulted in excess WaveSwitch 100 inventory.

Other Income

An increase of \$.2 million in interest income in 1996 as a result of excess cash was offset by a loss on foreign exchange of \$.2 million. Although not currently significant, the Company has a net United States dollar foreign exchange exposure which could be adversely effected by any comparative strengthening of the Canadian dollar.

PLAINTREE SYSTEMS INC.
MANAGEMENT DISCUSSION AND ANALYSIS

LIQUIDITY AND CAPITAL RESOURCES

The Company closed fiscal 1996 with a cash and cash equivalents position of \$6.4 million (1995 - \$3.3 million) and an additional available and un-utilized credit facility of \$3.1 million.

Net cash flow of the Company for fiscal 1996 was \$3.1 million versus a negative cash flow of \$4.0 million for the previous 1995 fiscal year. This positive cash flow was on the strength of a public share offering on NASDAQ early in the year which yielded approximately \$18 million. Proceeds from this offering negated the negative cash flow from operations of \$11.0 million (1995 - negative cash flow of \$11.7 million) and investment in capital assets of \$4.4 million (1995- \$1.7 million) including the purchase of a 20,000 square foot manufacturing facility.

The Company's trade accounts receivable were \$6.5 million at March 31, 1996 compared to \$13.8 million at March 31, 1995. The significant decrease in the comparative year-end receivable level is a result of a decrease in the corresponding year-over-year fourth quarter sales of \$5.2 million. The Company insures its accounts receivable and has not experienced any significant loss on bad debts since its inception.

Inventory levels at March 31, 1996 were \$12.4 million compared to \$7.7 million at March 31, 1995. Inventory has been decreasing since it reached a high level mark of approximately \$19 million in the third quarter of the fiscal year. A reserve for excess inventory was taken in the third quarter and, as at year-end, all projected excess inventory is adequately provided for. Inventory levels at year-end also include new generation products and components which had just commenced commercial shipment immediately prior to the end of the fiscal year.

In July 1996, the Company completed a private equity placement resulting in net proceeds to the Company of approximately \$6.3 million. The proceeds of this offering will be utilized for working capital needs and for the purchase of capital assets.

The Company believes that the net proceeds of this offering, its current working capital, its existing line of credit and the cash flow generated from future operations will be sufficient to meet the Company's working capital requirements for the next 12 months.

Plaintree Systems Inc.

Board of Directors

Peter S. Crombie
President and Chief Executive Officer, BCE Capital Inc.

Desmond Cunningham
Former Chairman, Co-Founder Gandalf Technologies Inc.

David M. Delaney
Chairman and Director of Product Development,
Plaintree Systems Inc.

Ian W. Delaney
Chairman and Chief Executive Officer, Viridian Inc.

Brian Kouri
Assistant Vice President and Treasurer, BCE Capital Inc.

Paula Ness Speers
President and Managing Director, Health Advances Inc.

Bruce V. Walter
President and Chief Executive Officer,
Plaintree Systems Inc.

Executives

David M. Delaney
Chairman and Director of Product Development

Bruce V. Walter
President and Chief Executive Officer

Alan D. Greenfield
Senior Vice President, Marketing and Sales

Thomas J. Branca
Vice President, Finance

David L. Hooper
Vice President, Business Development

Girvan L. Patterson
Vice President, International Sales and Secretary

Paul F. Weiss
Vice President, Marketing

Philip J. Wilkinson
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Stock Exchange Listings

NASDAQ Stock Market - Symbol: LANPF
Toronto Stock Exchange - Symbol: LAN

Plaintree Web Site

<http://www.plaintree.com>



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